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Outlook for the Economy and Real Estate

REALTOR®

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The Outlook for the Economy and Real Estate

Economic growth is expected to rebound only modestly during the second half of the year buoyed in part by consumer spending. The onset of tax reform will likely stimulate spending over coming months as consumers accelerate purchases of big-ticket items in order to deduct sales tax before the January 1 deadline. Further, this "buy-forward" attitude has been reinforced by deep-discounted auto financing as automakers attempt to clear out 1986 models. However, the impact of strong growth in consumer spending on overall economic activity should be diminished as a large part of this demand will continue to be satisfied by imports and existing inventories. The two key developments expected to dampen growth during the last half of the year will be GM's announced cutback in production and the likely further decline in net exports. As a result, growth in real GNP of 2.1 and 2.6 percent is expected in the third and fourth quarters with an annual average rate of growth of 2.5 percent expected for all of 1986.

Fiscal policy is expected to dominate the outlook in 1987 as both tax reform and Gramm-Rudman-Hollings(GRH) have adverse near-term effects on growth. The repeal of the Investment Tax Credit (ITC) and the lengthening of depreciation schedules for structures and most equipment should dampen overall investment spending next year. Real estate investment will likely be "hard-hit" by the loss-limitation provision which prevents investors from using losses from real estate investments to offset other types of income. Further, cutbacks in spending by both the federal government and consumers should also place a considerable drag on economic activity next year. Adherence to GRH deficit targets will restrain spending by the government and rising debt burdens as well as negligable growth in after-tax personal income should limit funds available for household consumption. As a result, real growth in GNP in 1987 is expected to increase at an annual average rate of only 1.6 percent with an expected improvement in net export growth providing the primary stimulus to economic activity. However, this forecast is not without risk. Any combination of the following would likely push the economy into a recession in 1987:

- a further deterioration in the nation's trade performance
- the potential for a steeper decline in investment and residential construction in response to tax reform.
- the failure of the FED to move aggressively to smooth the transition to tax reform and fiscal restraint associated with the GRH Deficit Reduction Law

The outlook for inflation remains quite favorable. The Consumer Price Index increased a modest 0.2 percent in August as shortages in poultry and eggs led to only temporary increases in food prices. Energy prices actually recorded a decline in August suggesting that the agreement by OPEC nations restraining oil production has yet to eliminate the oversupply of petroleum products. In addition, inflation rates for services have subsided, reflecting the slow but steady easing of labor costs in the service-producing industries. A modest re-acceleration in inflation is expected next year as oil

prices resume their upward trend once the existing oversupply is diminished. However, continued wage restraint should lower labor costs holding the overall inflation rate to 3.5 percent in 1987 and 4.0 percent in 1988.

The September employment report dashed hopes that more than a modest rebound would occur during the last half of the year. After 3 consecutive months of decline, the civilian unemployment rate rose 0.2 percentage points in September to 7.0 percent. Nonagricultural employment increased a meager 107,000 workers in September. Further, after accounting for the effect of striking workers and others returning from strikes, employment increased just 77,600 after rising 198,000 in August. The report underscored the continued weakness in manufacturing as manufacturing employment, after holding steady in August, resumed it downward trend in September. Even employment in the construction industry, which had been rising in recent months in response to a healthy housing market, recorded no change in September. Employment growth is expected to continue to slow through next year pushing the unemployment rate to above 7.5 percent by the end of 1987.

Long-term interest rates increased over a 1/2 percentage point over the past month spurred in part by anxiety in the bond market about renewed inflation, stronger growth and the recent decline in the dollar. However, most of these fears are not expected to be realized. While rate of inflation should accelerate modestly next year to 3.5 percent, a weakening in economic activity and slower wage gains should keep a lid on overall inflation. Further, while a rebound in the second half of the year is likely, it is expected to be quite modest and followed by renewed weakness in 1987. Finally, the recent depreciation of the dollar has raised concern that foreigners will shy away from dollar-denominated assets for fear of future depreciation. However, so far foreigners continue to have a healthy appetite for U.S. securities and there is little evidence that it will be diminished in the near-term. Subsequently, both long-and short-term interest rates are expected to continue to slowly trend downward through next year and into 1988.

Real Estate Markets

The single-family housing market remains one of the few bright spots in the economy. The annual pace of existing single-family home sales jumped 7.0 percent from July to August to a 3.69 million seasonally-adjusted annual rate -- the highest level during this decade. New construction of single-family units, while retreating below the 1.2 million unit level reported over the past six months, increased at a healthy pace of 1.197 million units in August. Despite an expected decline in mortgage interest rates through 1987, the pace of existing home sales is expected to slow slightly next year in response to slower growth and tax reform. Existing home sales are expected to decline to 3.44 million units in 1987 compared to an expected rate of 3.47 million units in 1986. New construction of housing is also expected to be adversely affected by tax reform, with sharpest declines expected in multi-family housing. In 1987, multi-family starts will likely decline as much as 25 percent, whereas single-family starts are expected to decline about 6 percent.

Table 1

October 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product													
(billions of dollars)	4,149	4,176	4,226	4,281	4,327	4,367	4,416	4,468	3,765	3,998	4,208	4,394	4,647
% Change	6.2	2.6	4.9	5.3	4.3	3.8	4.6	4.8	10.5	6.2	5.3	4.4	5.7
% Change (w/out inflation)	3.8	0.6	2.1	2.6	1.4	0.8	1.5	1.7	6.4	2.7	2.5	1.6	2.5
Consumption	3.6	6.2	6.3	0.6	1.4	1.1	1.1	1.2	4.7	3.5	4.1	2.0	2.2
Durables	1.8	14.3	22.5	10.3	-6.0	-1.5	0.2	1.9	12.7	7.8	5.0	-0.4	3.4
Nondurables	6.5	8.0	3.4	2.6	2.4	1.3	1.1	1.1	3.6	1.6	4.3	2.4	2.0
Services	3.2	2.6	3.7	2.9	2.9	1.8	1.4	1.1	3.4	3.7	3.6	2.5	2.1
Residential Investment	11.0	14.5	-1.7	-3.3	-7.4	-8.9	-4.5	-3.5	14.3	3.9	7.4	-4.4	-0.5
Nonresidential Investment	-15.1	-0.9	1.0	0.7	0.1	-2.4	1.1	2.1	16.9	9.3	-0.9	-0.8	0.6
Structures	-10.8	-35.2	-4.8	-3.2	-1.1	-0.5	2.2	1.3	11.1	7.7	-10.9	-3.3	2.1
Equipment	-17.0	19.6	3.4	0.3	0.6	-3.5	-2.4	-3.4	20.0	10.1	4.0	0.2	0.0
Exports	7.1	-9.8	1.8	5.8	7.0	6.2	6.1	5.8	6.2	-2.0	0.1	4.2	5.9
Imports	0.2	15.8	5.4	1.6	-1.6	-3.6	-3.6	-3.0	23.2	3.8	9.0	0.1	1.0
Government Purchases	-12.3	9.7	2.5	-9.6	-8.5	0.3	3.2	7.5	4.0	6.8	3.2	1.3	0.9
Contribution to GNP Growth (Percentage Point)													
Consumption	2.3	4.0	4.1	0.4	0.9	0.7	0.7	0.8	2.4	2.3	2.7	0.8	2.0
Residential Investment	0.5	0.7	-0.1	-0.2	-0.4	-0.5	-0.2	-0.2	0.2	0.4	0.2	-0.3	0.1
Nonresidential Investment	-2.1	-0.1	0.1	-0.1	0.0	0.3	-0.1	0.3	1.7	0.8	0.5	-0.2	0.3
Structures	-0.5	-1.7	-0.2	-0.1	0.0	0.0	0.1	0.0	0.5	0.1	-0.6	0.0	0.1
Equipment	-1.6	1.6	0.3	0.0	-0.1	0.3	-0.2	0.3	1.2	0.7	0.1	-0.2	0.2
Inventory Change	5.1	-2.7	1.5	0.2	1.9	-0.4	-0.6	-1.2	0.2	-1.1	0.2	-0.1	0.1
Net Exports	0.7	-3.0	-0.9	0.3	0.9	1.1	1.1	1.0	1.4	-1.1	-0.8	1.0	0.5
Government Purchases	-2.6	1.9	0.5	1.9	-1.8	0.1	0.6	1.5	1.5	1.6	0.4	0.1	0.1
Mfg. Capacity Utilization Rate	79.9	79.2	79.5	79.5	79.2	78.7	78.5	78.4	80.8	80.3	79.5	78.7	79.3
Domestic Auto Sales	7.8	8.1	9.3	7.0	6.9	7.0	6.8	6.8	8.0	8.2	8.1	6.9	7.1
Personal Income Per Household	41,477	41,985	42,188	42,571	42,997	43,358	43,744	44,151	38,154	40,285	42,047	43,568	45,309
Percent Change -- Year Ago	4.5	4.7	4.5	3.9	3.7	3.3	3.7	3.7	8.6	5.6	4.4	3.6	4.5
Personal Taxes Per Household	6,011	6,084	6,142	6,227	6,086	6,170	6,258	6,349	5,393	5,913	6,114	6,216	6,048
Percent Change -- Year Ago	-1.0	9.6	3.0	2.7	1.2	1.4	1.9	2.0	6.2	9.6	3.4	1.7	-2.7
Percent of Personal Income	14.5	14.5	14.6	14.6	14.2	14.2	14.3	14.4	14.1	14.7	14.5	14.3	13.3
Disposable Personal Income Per Household	35,466	35,900	36,046	36,344	36,911	37,188	37,487	37,802	32,761	34,372	35,933	37,352	39,460
Percent Change -- Year Ago	5.5	3.9	4.8	4.1	1.2	1.4	1.9	2.0	7.1	9.6	3.4	1.7	-2.7
Employment (millions)	108.8	109.2	110.0	110.0	110.2	110.2	110.4	110.6	105.0	107.2	109.5	110.4	111.7
(civilian:household basis)													
% Change	2.9	1.7	2.9	0.0	0.6	0.3	0.7	0.8	4.1	2.1	2.2	0.8	1.2
Unemployment Rate (%) (civilian)	7.1	7.2	6.8	7.0	7.2	7.5	7.6	7.6	7.5	7.2	7.0	7.5	7.4
Consumer Prices (CPI)	1.4	-1.7	3.0	4.0	4.1	3.9	3.9	3.8	4.3	3.5	2.0	3.5	3.9
GNP Deflator	2.5	1.8	2.9	2.6	2.8	3.0	3.0	3.1	3.9	3.3	2.7	2.8	3.2
Personal Cons. Inflation	1.1	-1.1	3.0	4.1	4.0	3.7	3.6	3.6	3.8	3.5	2.1	3.4	3.6
Residential Construction Inflation	3.0	5.6	3.3	3.4	3.8	3.8	3.8	3.9	4.1	1.8	3.5	3.8	4.2
Nonresidential Const. Inflation	3.7	-0.4	1.6	1.8	2.9	3.3	3.5	3.5	-0.2	0.7	1.2	2.5	3.7
Producer Price Inflation	-5.8	-5.1	1.4	3.1	3.9	3.7	3.7	3.8	2.1	0.9	-1.2	2.8	4.0
Before Tax Corporate Profit	224.3	231.3	246.8	269.5	258.8	256.2	259.7	268.9	235.7	223.1	245.0	260.9	288.3
Corporate Tax Liability	89.1	93.3	104.7	114.3	140.0	137.5	118.7	122.6	95.4	91.7	109.4	129.7	130.3
After-Tax Profits	135.2	138.0	142.1	155.2	118.8	118.7	141.0	146.3	140.3	131.4	142.6	131.2	158.0
Inventory Valuation Adjustment	16.5	10.6	-2.1	-7.5	-8.2	-6.4	-4.1	-4.8	-5.5	-0.5	4.4	-5.8	-5.7
Capital Consumption Allowance	55.6	51.3	52.0	51.9	48.8	45.0	41.1	37.2	34.5	58.1	52.7	43.0	27.0
Federal Tax Receipts (NIPA)	800	808	825	840	863	869	860	873	727	787	818	866	866
% of GNP	19.3	19.3	19.5	19.6	19.9	19.9	19.5	19.5	19.3	19.7	19.4	19.7	18.6
Federal Expenditures (NIPA)	1,002	1,046	1,034	1,067	1,048	1,056	1,073	1,099	897	985	1,037	1,069	1,107
% of GNP	24.1	25.0	24.5	24.9	24.2	24.2	24.3	24.6	23.8	24.6	24.6	24.3	23.8
Deficit(NIPA)	-202	-238	-209	-227	-185	-187	-213	-227	-170	-198	-219	-203	-240
% of GNP	4.9	5.7	4.9	5.3	4.3	4.3	4.8	5.1	4.5	4.9	5.2	4.6	5.2
% of Net Domestic Savings	59.7	73.4	77.3	81.8	70.7	77.1	82.4	88.2	51.8	63.4	72.4	80.4	83.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

Table 2

October 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS						YEARS				
	Actual		Forecast				Actual		Forecast		
	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions)	4,472	4,671	4,742	4,778	4,621	4,593	4,541	4,508	3,933	4,254	4,666	4,566	4,598
Percent Change -- Year Ago	11.3	14.5	8.3	5.2	3.3	-1.7	-4.2	-5.6	5.1	8.2	9.7	-2.1	0.7
Existing Single-Family Home Sales (1000's)	3,257	3,470	3,573	3,579	3,488	3,469	3,421	3,401	2,866	3,214	3,470	3,445	3,460
Percent Change -- Year Ago	10.3	14.0	6.3	2.3	7.1	0.0	-4.3	-5.0	5.5	12.1	8.0	-0.7	0.4
Dollar Volume (billions)	307.4	348.7	338.9	340.4	331.8	336.5	334.5	329.5	247.1	291.3	333.8	333.1	351.3
Existing Home Prices - Median ($1000's)	78.1	82.0	80.0	78.9	81.4	83.9	84.1	82.5	72.4	75.5	79.8	83.0	86.2
Percent Change -- Year Ago	4.6	8.6	4.4	4.9	4.3	2.3	-5.1	4.6	3.6	4.4	5.7	4.0	3.9
Monthly Mortgage Payment (P&I,80%,30 yr.)	583.6	587.6	562.0	538.0	518.1	525.3	520.4	505.0	618.0	609.0	567.8	517.2	513.6
Percent of Median Family Inc	25.0	24.9	23.8	22.6	22.5	22.6	22.2	21.3	28.2	26.2	24.1	22.1	21.1
Housing Starts (1000's)	1,998	1,908	1,809	1,791	1,671	1,660	1,629	1,605	1,763	1,741	1,877	1,641	1,678
Percent Change	13.4	9.5	7.2	1.0	-16.4	-13.0	-9.9	-10.4	3.4	-1.2	7.8	-12.5	2.3
Single-Family Units (1000's)	1,253	1,238	1,205	1,236	1,168	1,159	1,155	1,142	1,100	1,073	1,233	1,156	1,173
Percent Change	14.0	15.8	14.9	15.1	-6.8	-6.4	-4.2	-7.7	3.3	-2.5	15.0	-6.2	1.5
Multi-Family Units (1000's)	746	670	604	555	503	501	474	463	663	669	644	485	505
2-4 Family Units	102	80.7	72.6	66.7	60.5	60.2	57	55.7	121.5	93.1	80.5	58.4	60.8
Percent Change -- Year Ago	0.7	-20.9	-18.7	-16.2	-40.7	-25.4	-21.5	-16.5	7.0	-23.4	-13.5	-27.5	4.1
5+ Family Units	643.7	589.7	531.0	488.0	442.5	440.3	415.9	401.0	541.9	575.8	563.1	426.8	444.3
Percent Change -- Year Ago	14.7	3.1	-3.5	-21.3	-31.2	-25.3	-21.5	-16.5	2.8	6.2	-2.2	-24.2	4.1
Mobile Homes Shipped	262	238	241	248	242	244	246	247	295	283	247	245	257
New Single Family Home Sales (1000's)	800	787	612	579	577	570	561	566	637	689	695	569	593
Percent Change -- Year Ago	19.9	15.7	-13.9	-16.8	-27.9	-27.6	-8.3	-2.2	1.3	8.1	0.9	-18.1	4.3
New Home Prices -- Median ($1000)	88.3	91.4	93.0	94.3	94.4	94.5	94.5	94.5	80.0	84.3	91.8	94.5	96.4
Percent Change -- Year Ago	6.5	8.8	11.5	8.6	6.9	3.4	1.6	0.2	6.0	5.4	8.9	2.9	2.0
New Home Prices -- Mean ($1000's,Quality Adj.)	102.9	107.8	107.8	110.4	107.6	111.7	111.8	114.6	96.8	104.0	107.3	111.4	116.1
Percent Change -- Year Ago	1.7	3.6	3.4	3.8	4.5	3.6	3.7	3.8	6.6	7.4	3.2	3.8	4.2
NAR Affordability Index	99.9	100.6	104.8	110.2	111.0	110.4	112.5	117.0	75.4	85.9	103.9	112.7	118.6
Mortgage Debt Outstanding($ billions)	2,354	2,389	2,422	2,488	2,556	2,620	2,684	2,748	1,948	2,202	2,413	2,652	2,911
Housing Inventory (millions)	96.3	96.8	97.3	97.7	98.2	98.6	99.0	99.4	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	6.9	7.3	7.1	6.9	6.8	6.7	6.5	6.4	5.8	6.5	7.1	6.6	6.2
Office Vacancy Rate (%)<1>	16.3	16.8	16.8	16.9	17.0	16.8	16.7	16.6	14.7	16.5	16.7	16.8	16.5
Industrial Vacancy Rate (%) <1>	5.3	5.7	5.8	5.7	5.7	5.6	5.6	5.5	4.7	5.0	5.6	5.6	5.4
FINANCIAL MARKETS													
Money Supply (M1)(% change)	7.9	16.8	18.8	12.1	10.1	7.3	7.1	6.4	7.0	9.1	12.9	10.7	6.3
Velocity of M1 (% change)	-1.6	-12.2	-11.7	-6.1	-5.3	-3.2	-2.4	-1.5	3.3	-2.6	-6.7	-5.8	-0.5
Value of the U.S. Dollar (Trade-Weighted)	119.5	114.2	108.0	106.6	105.2	104.4	103.6	102.8	138.3	143.2	111.9	104.0	100.9
Percent Change	-24.5	-16.5	-20.1	-7.2	-3.0	-3.0	-3.0	-3.0	10.4	3.5	-21.9	-7.1	-3.0
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	715	719	670	680	663	663	688	694	675	688	696	677	744
Personal Saving	146	153	109	107	124	119	116	115	169	143	129	118	147
Savings Rate	5.0	5.1	3.6	3.5	4.0	3.8	3.7	3.6	6.3	5.1	4.3	3.8	4.4
Gross Business Savings	569	566	561	573	539	544	571	579	506	544	567	558	597
Federal Deficit	202	238	209	227	185	187	213	227	170	198	219	203	240
State & Local	70	59	58	61	60	59	58	58	69	62	62	59	62
Net Foreign Investment	129	143	142	156	161	168	162	159	91	115	142	161	154
Uses (total gross investment)	708	687	678	681	700	694	691	681	662	661	689	691	721
Nonresidential Investment	458	457	458	457	457	454	453	451	422	461	457	454	457
Structures	148	133	131	130	131	131	132	132	141	152	136	131	134
Equipment	310	324	327	327	326	324	322	319	281	309	322	323	323
Residential Investment	186	193	192	190	187	182	180	179	171	177	190	182	181
Inventory Investment	40	15	1	3	20	16	11	-1	59	9	15	12	13
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	10.4	9.9	9.8	9.5	9.3	9.1	9.0	8.9	13.8	12.2	9.9	9.1	8.7
Real Mortgage Rate<3>	4.4	4.4	4.6	4.7	4.9	4.9	5.1	5.3	6.4	5.5	4.5	5.0	5.4
1-year ARM (without buydown)	9.6	9.2	7.8	7.3	7.0	6.8	6.7	6.6	12.5	10.1	8.5	6.8	5.4
Real Mortgage Rate	7.1	7.4	4.9	4.7	4.2	3.8	3.7	3.5	8.6	6.8	5.8	4.0	2.2
Corporate AAA Bond Rate	9.6	9.0	8.8	8.6	8.3	8.1	8.0	7.8	12.7	11.4	9.0	8.0	7.3
Government Bond Rate	8.9	7.7	7.4	7.2	6.9	6.7	6.6	6.4	12.5	11.0	7.8	6.6	6.0
Real Government Bond Rate	2.9	2.2	2.2	2.4	2.5	2.5	2.7	2.8	5.1	4.3	2.4	2.6	2.7
Federal Funds Rate	7.8	6.9	6.2	5.7	5.5	5.3	5.2	5.1	10.2	8.1	6.7	5.3	5.4
3-month T-Bill Rate	7.0	6.1	5.6	5.1	4.8	4.6	4.5	4.4	9.5	7.5	6.0	4.6	4.7
Real 3-month T-Bill Rate	4.5	4.3	2.7	2.5	2.0	1.6	1.5	1.3	5.6	4.2	3.3	1.8	1.5
1-Year T-Bill Rate	7.9	7.5	6.1	5.6	5.3	5.1	5.0	4.9	10.9	8.4	6.8	5.1	5.2
Real 1-Year T-Bill Rate	5.4	5.7	3.2	3.0	2.5	2.1	2.0	1.8	7.0	5.1	4.1	2.3	2.0
Prime Rate	9.4	8.6	7.9	7.3	7.2	6.7	6.8	6.8	12.0	9.9	8.3	6.9	6.7
Discount Rate	7.4	6.6	5.8	5.2	5.1	4.8	4.7	4.7	8.8	7.7	6.3	4.8	4.7

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates = Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns